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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In The Matter of

Implementation of the
Pay Telephone Reclassification
And Compensation Provisions of the
Telecommunications Act of 1996

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CC Docket No. 96-128

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FEDERAL COMMUNICATIONS COMMISSION
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COMMENTS OF CABLE AND WIRELESS, INC.

CABLE AND WIRELESS, INC.

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SUMMARY

On this second remand, the Commission should not repeat the mistakes of its first two orders. The problem with its local coin approach is not that the FCC failed to adjust the default rate by a few pennies, or that it needs to explain itself better. Rather, the flaws in the approach are much more fundamental. These flaws are illustrated by the Court's two principal concerns regarding the local coin approach.. First, what evidence is there that the local coin rate is itself a competitive rate? That is, what evidence is there that costs and rates converge in the local coin market? Second, why, if the markets for local calls and subscriber 800 or access code calls are different, does it make any sense to tie the compensation rate for one to the "market rate" for the other? CWI submits that the answers to these questions lead inexorably to the conclusion that the local coin approach must be abandoned.

Instead of attempting to prop-up this discredited approach, the Commission should revise its entire approach to payphone compensation. It either should set compensation at a cost-based rate (of approximately \$.10 to \$.15 per call) or it should establish a true market for access code and subscriber 800 calls by adopting a caller pays approach. In either case, the Commission needs to place its local coin approach behind it, once and for all.

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COMMENTS OF CABLE AND WIRELESS, INC.

Cable and Wireless, Inc. ("CWI"), by its attorneys, respectfully submits the following comments in response to the Common Carrier Bureau's *Public Notice* regarding issues presented on remand in the above-captioned docket.¹ CWI submits that the Commission can respond to the Court's concerns only by abandoning its misguided attempt to use the local coin rate as a "market-based" surrogate for access code and subscriber 800 compensation. In its place, the Commission should establish a reasonable, cost-based compensation amount or, if it believes a "market approach" is needed, should create such a market by adopting the caller pays compensation method.

I. INTRODUCTION

It is highly unusual that the Commission is reversed twice in the same proceeding for the same error. Yet both times, the Commission has erred by using the local coin rate to prescribe grossly excessive compensation for subscriber 800 and access code calls. In the initial *Payphone*

¹ Pleading Cycle Established for Comment on Remand Issues in the Payphone Proceeding, DA 98-1198 (rel. June 19, 1998) (*Public Notice*); see *MCI Telecommunications Corporation, et al. v. FCC*, slip op. (D.C. Cir. No. 97-1675 May 15, 1998) (*Payphone II*).

Orders,² the Commission prescribed compensation at an amount equal to a presumed market rate for local calls (\$.35). In the *Second Report and Order* (issued after the Court's first remand in this proceeding), the Commission made only slight changes to its compensation plan. Purporting to address the differences in cost between a local coin call, on the one hand, and subscriber 800 and access code calls, on the other, the Commission reduced the compensation amount to \$.284.³ Critically, however, the *Second Report and Order* relied again on the local coin rate as a surrogate for subscriber 800 and access code compensation.

Both times, the Court of Appeals has found the logic of the FCC's approach sorely lacking. As the Court in *Payphone II* explained, "The Commission never explained why a market-based rate for coinless calls could be derived by subtracting costs from a rate charged for coin calls."⁴ This approach is wholly "unreasoned" if the FCC is subtracting one quantity from another, logically independent, quantity.⁵ Yet the Commission never established the connection between the coin rate and the compensation amount it sought to determine.

On this second remand, the Commission should not repeat the mistakes of its first two orders. The problem with its local coin approach is not that the FCC failed to adjust the default rate by a few pennies, or that it needs to explain itself better. Rather, the flaws in the approach are much more fundamental. These flaws are illustrated by the Court's two principal concerns regarding the local coin approach.. First, what evidence is there that the local coin rate is itself a

² *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Report and Order, 11 FCC Rcd 20,541 (1996), Order on Reconsideration, 11 FCC Rcd 21,333 (1996).

³ *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Second Report and Order, 13 FCC Rcd 1778, ¶ 42 (1997).

⁴ *Id.* at ¶ 41.

⁵ *Id.*

competitive rate? That is, what evidence is there that costs and rates converge in the local coin market? Second, why, if the markets for local calls and subscriber 800 or access code calls are different, does it make any sense to tie the compensation rate for one to the “market rate” for the other? CWI submits that the answers to these questions lead inexorably to the conclusion that the local coin approach must be abandoned.

II. THE LOCAL COIN RATE DOES NOT REFLECT PSP COSTS IN COMPLETING LOCAL CALLS

The *Public Notice* seeks comment on a number of issues relating to the first of the two premises underlying the use of a local coin rate as a basis for compensation. As the Court noted, the Commission’s previous orders assumed that the market rate for coin calls reflects the costs of those calls. This assumption is wrong, however.

A. Deregulation Has Increased Coin Rates to 35 Cents without Any Noticeable Change in Payphone Deployment

The *Public Notice* seeks comment on the level of competition in the payphone market since deregulation of the local coin rate, and the impact of such deregulation on the rates charged end users.⁶ Unfortunately, deregulation of the local coin rate has not produced competition in the local coin rate.

Instead, the only change brought on by deregulation has been an increase in local coin rates. Given cover by the FCC’s declaration of \$.35 as the “market rate,” all major PSPs quickly raised their coin rates to \$.35 per call. This increase is costing consumers over \$1 billion

⁶ *Public Notice* at 2.

annually in additional payphone charges, without any increase in consumer benefits.

The uniformity of the coin rate increase illustrates that the nature of competition in the payphone industry does not include competition for the rates paid by end users from payphones. This evidence suggests instead that the locational monopoly is the norm, not the exception, in end user competition at payphone locations. Competition for location owners through the payment of commissions does not ensure that end user rates are competitive. Although the competition for these commissions is intense, the location owner has little incentive after selecting a PSP to keep end user rates down. To the contrary, because the location owner's commission typically is a percentage of revenue, the location owner has an incentive to cooperate with the PSP in increasing end user charges as much as possible. As a result, the PSPs' pricing tends to reflect more the limit of monopoly pricing power than the result of end user price competition.

Although PSPs frequently claimed in earlier phases of this proceeding that higher revenues would promote an increase in deployment of payphones, empirical evidence of this effect is lacking. PSPs have known since September 1996 that coin rates soon would be deregulated, and all major PSPs rapidly increased their coin rates to \$.35 after deregulation took effect in October 1997. However, the prospect of these new revenues has not encouraged them to deploy more phones. At least among the largest public PSPs, it appears that they are deploying new payphones (as opposed to increasing their base through acquisition) at approximately the same pace they had been prior to the new compensation rates.⁷ Instead, although consumers are paying approximately \$1 billion more for local payphone calls, they are receiving the same level of payphone service they received in the past.

B. There is no Evidence that Costs and Rates Converge in the Local Coin Market

Viewing competition from another way, the experience since deregulation of coin rates does not bear out the proposition that costs and rates converge in the coin call market. As discussed above, PSPs have uniformly increased their local coin rates to \$.35 in response to deregulation. If costs and rates converged in the local coin market, however, one would expect significant variances in the local coin rate. These variances should exist, but do not, by geography, by density of payphones, and by PSP.

If costs and rates converged, one would expect coin rates to vary by geographic region of the country, because costs vary by region. Payphone access line charges are not uniform nationwide, and instead can vary significantly from one LEC to another. In addition, installation costs vary by the type of enclosure needed to protect against the elements. As a result, areas with more severe weather conditions and more outdoor locations should result in higher costs than mild regions or regions in which more payphones are shielded by other structures. Factors such as these should result in significant cost variances among payphones located in different regions, even where a single company operates in multiple regions. If the coin rate were reflective of these variances, it too would be higher in some regions and lower in others.

Because costs also can vary by type of location, one should expect to see variation in the rates charged at a given location. For example, some locations have higher instances of vandalism and other damage to the payphone, which would make those phones more expensive

(...continued)

See, e.g., Peoples Telephone Company, SEC Form 10-Q at 7 (filed 5/15/98) (although payphone base increased by 4,000 phones, only 1,400 were due to new installations).

to operate. Differences in enclosure costs should make indoor telephones generally cheaper than outdoor phones. Moreover, if substitutability of services were a significant constraint on payphone rates, one would expect coin rates to vary by phone location, because factors such as the proximity of other phones or the availability of alternative calling mechanisms would be different for each location.

For similar reasons, costs – and rates – should vary by PSP. Maintenance and field service costs can be significantly affected by the cost of labor. To the extent that PSPs have higher or lower than average labor costs, they should encounter different overall costs. Similarly, PSPs receive their equipment from different vendors, with different levels of functionality and different prices. Thus, one would expect some PSPs to have a cost advantage over their competitors, which might result in lower overall coin rates. In addition, large LECs appear to be more efficient in their payphone operations, which should give them a price advantage over competing non-LEC PSPs.

All of these cost differences are real, and all must be reflected in the competition among PSPs. The fact that the local coin rate is uniformly set at \$.35 – regardless of PSP, geographic region, or the proximity of competing phones – suggests that the competition does not reflect these differences in coin rates. In other words, PSP costs do not converge with end user rates, at least not in the coin rate. Rather, cost differences are reflected in other aspects of competition among PSPs. Most likely, these cost differences are being reflected in the commissions that they offer to location owners for the right to install a payphone. That is where one sees the variation among providers or locations, not in the local coin rate.

III. THE MARKET FOR LOCAL COIN CALLS IS NOT A SURROGATE FOR ACCESS CODE OR SUBSCRIBER 800 CALLS

Regarding the second premise essential to the compensation schemes remanded by the courts of appeal, the *Public Notice* asks for comment on the similarities and differences between the markets for coin and coinless calls and the factors attributable to those differences.⁸ It also asks whether and how those differences should affect the determination of a default compensation level for subscriber 800 and access code calls.⁹ As shown below, the local coin and coinless markets are substantially different, with different actors and market dynamics for each. These differences preclude the use of the local coin rate as a surrogate for coinless compensation rates.

Most significant among the differences between the markets is the difference in which parties are responsible for payment for the call. In the local coin market, the caller is the buyer of the service. The caller decides whether to place the call, based on factors such as the price for the call, the availability of change, and the convenience of using the phone at that time. Critically, at the time of the purchase decision, the caller knows the rate to be charged and has the ability to determine on a case by case basis whether to place the call (and therefore incur the charge).

By contrast, in the access code and subscriber 800 markets, the buyer of an access code or subscriber 800 service frequently is not the caller placing the call. For subscriber 800 calls, the buyer is never the caller, but is the called party. For access code calls, the buyer can be

⁸ *Public Notice* at 2-3.

⁹ *Id.*

the calling card holder (in the case of a card call),¹⁰ the called party (collect calls) or a third party (third number billed calls). As a result, the buyer of an access code or subscriber 800 service is not subject to the same factors as is the caller in the local coin market. Equally importantly, the *caller* in an access code or subscriber 800 context is virtually indifferent to the cost of the call being placed.

Due to these differences, the markets for local coin calls and for subscriber 800 or access code calls will not operate in the same manner. Changes that can affect the local coin market, such as the availability (or lack thereof) of sufficient coins, will not affect the access code or subscriber 800 markets. Similarly, the factors that an IXC or 800 subscriber would weigh to determine whether to accept a payphone-originated call are not the same as those that would be weighed by the caller in a local coin situation. Therefore, the local coin market will not reflect a market for access code or subscriber 800 calls. It cannot be used as a surrogate for the market price of those calls.

In the *Second Report and Order*, the Commission suggested that the presence of significant joint and common costs in payphone calling justified tying the compensation amount to the local coin rate. The presence of joint and common costs, however, does not overcome the fundamental differences among these markets. As the Court concluded, the mere existence of joint and common costs is “utterly unhelpful,” for it does not explain why the “market rate” for a coin call, even if certain costs are deducted, would be the same as the market rate for a coinless call.¹¹ That is, there is nothing about the presence of joint and common costs that guarantees the markets will move in tandem.

¹⁰ The card holder can be, but is not always, the caller.

¹¹ *Payphone II*, slip op. at 12.

Indeed, the “joint and common cost” rationale proves too much. It is true for all payphone calls that these joint and common costs exist. If the existence of these costs linked the rates of payphone calls, then the local coin rate would be linked to other types of payphone calls, not just subscriber 800 or access code calls. However, there is no evidence that the market rate for a 0+ call, for example, moves in tandem with the market rate for a local coin call. Similarly, if joint and common costs linked payphone calls, a relationship should exist not only between the coin rate and other types of calls, but between any two types of payphone calls. Yet, all evidence indicates these markets operate independent of one another. Accordingly, there is no basis for concluding that the local coin market is a surrogate for any other type of payphone calling market, including coinless calling markets.

IV. THE COMMISSION EITHER SHOULD PRESCRIBE COST-BASED COMPENSATION OR SHOULD CREATE A TRUE MARKET FOR ACCESS CODE OR SUBSCRIBER 800 CALLS

Rather than attempting to support an unsustainable local coin approach, the Commission should revise its course and prescribe compensation on a new basis. The Commission has several rationales it may choose from to arrive at “fair compensation.”

A. The Commission Should Adopt a Cost-Based Compensation Amount

The Commission should set a fair compensation amount using reliable and representative cost information. Cost-based compensation is fair, is consistent with Section 276, and will promote the widespread deployment of payphones and of payphone services to the public. CWI has always favored a cost-based approach as the most reasonable and fair to all parties. The Commission should adopt that approach now.

It is critical, however, that the cost-based approach reasonably reflect the costs of the

payphone industry as a whole. In the *Second Report and Order*, the Commission purported to calculate an alternative “bottom-up” cost for payphone calls, but that cost figure was reached only by systematically ignoring LEC cost data and by inflating costs to reflect a hypothetical “low volume” payphone.¹² Neither adjustment appropriately reflects the costs of the payphone industry as a whole. Moreover, even though the Commission conducted this calculation, it (rightly) never relied upon it.¹³ Thus, in conducting a cost analysis on remand, the Commission should reject its previous calculation and conduct it anew using proper data and proper assumptions.

Any cost analysis must reflect the fact that LECs operate approximately 75 percent of the payphones in the nation. These LECs, many of which are several times larger than the largest independent PSP, also appear to be more efficient than the average independent PSP. Data illustrating the LECs’ substantially lower costs has been presented in several forms in the record, including analyses of Bell Atlantic’s cost of operating payphones in Massachusetts,¹⁴ of the Sprint LECs’ costs,¹⁵ and of SBC’s Southwestern Bell Telephone payphone division.¹⁶ This data shows that the cost of originating access code and subscriber 800 calls is in the range of \$.10 -.15 per call, far below the compensation that the Commission previously prescribed. Relying on this and any other reliable data submitted in this proceeding, the Commission should set a cost-based compensation amount of no more than \$.15 per call.¹⁷

¹² *Second Report and Order* at ¶ 99, 118.

¹³ *Id.*

¹⁴ Sprint 1997 Remand Comments at 8-10.

¹⁵ Sprint 1997 Remand Reply Comments at Exhibit 1.

¹⁶ AT&T Petition for Reconsideration at Robinson Aff., Attachment I.

¹⁷ As a third alternative, CWI does not object to using the AT&T/APCC negotiated access code compensation amount as evidence of the market rate for access code calls. Provided that this amount is adjusted to reflect the different market characteristics of subscriber 800 calls, the
(continued...)

B. In the Alternative, A System Where the Caller Deposits Coins to Make an Call is the Only True Market-Based Alternative

If the Commission is committed to creating a market-based compensation rate, rather than setting cost-based compensation, it should do so on the basis of a market that can actually work, not on a surrogate market that bears no relationship to coinless calling. Fortunately, a direct market in coinless calls is available to it. Specifically, if the Commission wishes to establish a market approach to compensation it should adopt the "caller pays" approach suggested by many commenters in this proceeding. The caller pays approach aligns the seller (the PSP) and the buyer (the caller) in a direct transaction, which sends the proper price signals for a functioning market.

Supporters of caller pays have shown that this approach is consistent with statutory principles, is feasible, and is the least costly method of administering payphone compensation. If the FCC is committed to a market approach to compensation, caller pays is the only appropriate option. At a minimum, the FCC cannot adopt a different market-based approach without explaining why that approach reflects the market for coinless calls better than caller pays would.

CONCLUSION

For the foregoing reasons, the Commission cannot sustain a compensation amount that is based in any manner on the local coin rate charged by PSPs. The local coin approach is not a surrogate for the costs of coinless calls because (1) there is no evidence that costs and rates

(...continued)

AT&T/APCC rate can be used in the calculation of a blended rate for both subscriber 800 and access code calls. See AT&T 1997 Remand Reply Comments at 12-14.

converge in the local coin market and (2) the local coin market operates independently of the access code and subscriber 800 calling markets. Accordingly, the Commission should abandon its attempt to establish "market-based" compensation using the local coin rate.

In replacement for the discredited local coin approach, CWI suggests compensation determined using one of two alternatives. First, the Commission should set cost-based compensation using reliable data representative of the payphone industry as a whole. This compensation would not exceed \$.15 per call. Second, if the Commission is determined to establish market-based compensation, it should adopt the caller pays approach, because that is the only approach that establishes a true market for access code and subscriber 800 calling

Respectfully submitted,

CABLE AND WIRELESS, INC.

A handwritten signature in dark ink, appearing to read "Rachel J. Rothstein/saa", is written over a horizontal line.

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